Credit Outlook 2019: No Need to Panic, Yet

Following positive credit conditions throughout the last few years, 2019 and soon after 2019 are predicted to trend downward, according to a recent analysis by Moody's Investor Service. Global credit conditions will likely weaken this year and default rates will continue to remain low moving forward.

"We do think global credit conditions will be weaker this year; volatility is now the name of the game, and credit conditions are becoming less accommodative," said Ann Van Praagh, managing director global strategy and research at Moody's. "We expect refinancing risks to be manageable for most of the leverage finance market, and we expect profitability and liquidity to remain solid."

Over the last handful of years, credit conditions remained ideal for issuers. The U.S. economy strengthened through 2017 and 2018 due to corporate tax cuts and a low level of unemployment, but 2019 does not promise any boosts to the economy. Many of the short-term fixes to the U.S. economy will wear off this year, increasing the volatility of corporate debt distress. While issuers will likely not see as many problems this year, the capital structures still remain weak.

The interruption of a healthy credit cycle began in December 2018, said Christina Padgett, SVP of Moody's Corporate Finance Group. Moody's rated the liquidity stress of the current credit cycle at 4%, which is below the record worst of nearly 21%, yet the cycle index still saw a more than 1% uptick since 2018. While this number is not yet a cause for concern, the change is still significant and can mean a trend of worsening credit health.

"Our credit cycle indicators show only a modestly worsening trend in credit conditions in 2019, based on fundamental credit factors," Padgett said. "Broadly speaking, our credit cycle gauge reflects metrics still below the long-term averages and meaningfully below the record worst around the time of the financial crisis."

Many of the upcoming risks will begin to manifest themselves this year, but the effects of these risks may not become apparent immediately, said Mariarosa Verde, VP-SCO credit strategy and standards at Moody's said. She said many of the risks involved with worsening credit do not become apparent because of a general lag within the industry: Before a customer has a difficult time paying a creditor, something must affect the customer's ability or willingness to pay. While some risk factors may begin to pop up, they will not reach the credit department as quickly.

Some of the pressure points Verde brought attention to involved record low-rated issuers, risk appetite showing signs of strain and particular industries facing economic strain (for example, oil and gas customers dealing with more debt than previous years). Generous market conditions for creditors has created an environment for more defaults, leading to worse recoveries in the event of an economic crisis.

"Neither corporate profit growth currently nor rating activity suggests there will be a meaningful upturn in the default rate in 2019," Verde said. "However, we would say an enormous amount is relying on the macro environment staying relatively good because we do have a record low number of well-rated issuers."

Should the economic health of the U.S. remain steady, the cause for creditors to panic will not be evident. According to Moody's analyses, the numbers are beginning to dip, and a large factor keeping the ratings up revolves around a healthy economy. Unlike 2017 and 2018, the momentum for 2019's economy began to slow. While this slowdown will not see any immediate impact on creditors, they should still be mindful of the possible dangers to come ahead later in the fiscal year.

— Christie Citranglo, editorial associate